



GOVERNOR'S BUDGET



MAY REVISION 2008-09

INTRODUCTION

California's structural budget deficit persists. Slower rates of economic growth, softening state revenues and increased costs have widened California's budget gap. In January, the projected deficit for 2008-09 was \$14.5 billion. Left unaddressed, the projected gap would grow to \$24.3 billion based on updated revenue projections, revised caseload estimates and higher costs. The single largest factor contributing to the increase in the projected budget gap is a \$6.0 billion decrease in estimated General Fund revenues. Other factors include increased program costs, higher estimates of growth and costs of living adjustments, and erosion of savings due to delays in the adoption of reduction proposals. (See Figure INT-01).

Figure INT-01

Defining the Budget Gap

(Dollars in Millions)

Governor's Budget	-\$14,479
Reserve	-2,009
Adjustments Since Governor's Budget	<u>-7,789</u>
Total Size of Problem	<u><u>-\$24,277</u></u>

INTRODUCTION

A productive Special Session of the Legislature made a down payment to address the budget deficit; now, the remaining budget gap is \$17.2 billion.

The Governor’s January Budget proposed difficult but necessary changes to address the state’s structural budget deficit. Specifically, it proposed spending restraint, including an average 10-percent reduction in the budget of almost every program, while protecting essential state services and the sale of authorized Economic Recovery Bonds to provide additional revenues. It also proposed budget reform to provide necessary tools to bring spending and revenues into alignment and to ensure the state does not spend beyond its means in future years. See Figure INT-02 below.

Figure INT-02

How to Close the Budget Gap

(Dollars in Millions)

Projected Shortfall			-\$24,277
Solutions:	<u>Revenue</u>	<u>Expenditures</u>	<u>Total</u>
Special Session	\$3,559	\$3,484	\$7,043
Proposed Solutions	\$8,130	\$9,104	\$17,234
Total	\$11,689	\$12,588	\$24,277

The May Revision proposes a combination of spending reductions and revenue solutions to address the budget gap and to provide for a responsible reserve of \$2 billion, and it does so without raising taxes. It proposes \$12.6 billion in expenditure reductions across state government. While it retains the vast majority of 10-percent across-the-board reductions proposed in January, the May Revision makes some important adjustments to address the larger deficit while protecting education and public safety. The May Revision fully funds the Proposition 98 guarantee and provides a modest increase in total funding for education in the budget year. It reflects approximately \$300 million in savings in the California Department of Corrections and Rehabilitation’s budget without the early release of inmates. It also includes funds to keep all of the state’s parks open, increasing fees where feasible to offset General Fund costs. The May Revision also makes additional difficult choices to reduce spending, including proposing \$627 million in additional

reductions to health and human services programs. Without comprehensive health care reform that infuses the health care system with additional, stable sources of funding, these services will unfortunately continue to be significantly impacted by California's broken and volatile budget system.

BUDGET REFORM

California's fiscal strength and security hinges on fixing our broken budget system.

In his State of the State speech, Governor Schwarzenegger proposed a constitutional amendment, the Budget Stabilization Act (BSA), to address two shortcomings in the state budget process: volatile revenues and over-spending. The BSA would prevent spending temporary increases in revenues on ongoing programs and give the state mechanisms to avoid future budget crises. It calls for the creation of the Revenue Stabilization Fund (RSF) where revenues above a reasonable, long-term average rate of growth will be deposited. Moneys in the RSF will only be available for transfers to the General Fund to bring revenues up to the long-term average in years with below-average revenue growth, such as 2008-09. The May Revision proposes to capitalize the RSF in 2008-09 and thus provide \$5.1 billion to the General Fund.

In addition to the proposed Budget Stabilization Act, Governor Schwarzenegger will issue an Executive Order to establish a bipartisan commission of legislative and gubernatorial appointees to modernize the state's tax laws and better reflect the current economy. The Tax Modernization Commission will be charged with recommending ways to stabilize California's revenues, to bring our tax system into better alignment with our modern economy and to improve the state's economic competitiveness.

IMPROVED PERFORMANCE OF THE LOTTERY

The California Lottery is an underperformer when compared to the other 40 states with lotteries. Per capita average sales in 2006 of all other states was \$189, and the average of the ten most populous states was \$225. In contrast, California's only had \$88 in average per capita sales. Clearly, there is room for a greater return on this public asset. The underperformance of the California Lottery stems from numerous restraints on its operation. The May Revision proposes to improve the performance of the state's lottery by providing operational flexibility similar to lotteries in most other states. The May Revision proposes to securitize future revenues resulting from the improved performance of the lottery to fund the RSF. This would be done in a manner similar to the Tobacco Securitization Act, which authorized the issuance of bonds against future tobacco settlement revenues. It is anticipated that the proposed bonds will

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yield \$5.1 billion in revenue for the state budget in 2008-09 and a total of \$15 billion by 2010-11, after providing education the \$1.2 billion in annual funding from the lottery that it currently receives.

FAIL-SAFE MECHANISM FOR RSF CAPITALIZATION

To ensure that the RSF has a sufficient balance to transfer \$5.1 billion to the General Fund in 2008-09, the May Revision includes a fail-safe mechanism that is similar to the mechanism established by Chapter 10, Statutes of 1983, which was signed into law by Governor Deukmejian. Under this mechanism, next year, the Director of the Department of Finance will determine whether the RSF has a sufficient balance for transfer to bring General Fund revenues up to the long-term average of General Fund revenue growth. If the RSF balance is insufficient, temporary a one-cent (\$.01) sales tax increase will be triggered. The triggered increase would remain in effect until the RSF has reached the targeted fund balance (15 percent of General Fund tax revenues) or until June 30, 2011, whichever occurs first. After this temporary mechanism is no longer in effect, Californians will receive tax rebates that in the aggregate will be equal to the amount of revenues collected under the temporary mechanism.

CONCLUSION

In summary, the Governor's May Revision responsibly addresses the state's structural budget deficit through a combination of necessary spending reductions and new revenue through better utilization of state assets. The proposed May Revision, coupled with the Budget Stabilization Act and the Tax Modernization Commission, will ensure that California not only closes its immediate budget gap without a tax increase, but it has the necessary mechanisms to prevent future budget crises.